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CITY COUNCIL REPORT

SUBJECT: General Fund Reserves

SUBMITTED BY: Jennifer Hanson, City Manager

DEPARTMENT: City Manager's Department

DATE: July 2, 2019

STRATEGIC RELEVANCE: Sustainable Fiscal Health

STAFF RECOMMENDATION(S):

Staff is requesting input from City Council on the City's General Fund Reserve Policy.

BACKGROUND / INTRODUCTION:

The current General Fund Reserve Policy was adopted by City Council on June 26, 2018 (attached). The policy includes a number of reserve designations: Operating, Catastrophic, Economic, Capital, Other Post Employee Benefits (OPEB), PERS, and Designated Reserves. Please see Attachment A for a description of each one of the City's reserves. City Council adopted an Interfund Loan between Airport Fund 750 and the General Fund. The adoption of the interfund loan reduced the General Fund's Catastrophic Reserve and Economic Reserve to \$0.

Prior to the adoption of the Interfund Loan, the projected ending General Fund reserve balance for 6/30/19 was approximately 70% of annual expenditures. However, if the OPEB and PERS reserves (they are considered self-restricted and not spendable) were removed from the reserve total, the remaining total reserve would be reduced to 55% of annual expenditures.

The table below provides the revised projected fiscal year-end reserve balances that are reflective of the approval of the Airport Interfund Loan and the adoption of the Annual Budget for Fiscal Year 2019/2020:





General Fund Reserve Analysis		6/30/19 Projected Ending Fund Balance	Potential Airport Interfund Loan Adjustment	6/30/19 Projected Revised Ending Fund Balance
100	Spendable Reserves	\$1,914,287.00	\$ (593,937.00)	\$ 1,320,350.00
	Operating Reserve	\$4,674,039.00		\$ 4,674,039.00
	Catastrophic Reserve	\$2,000,000.00	\$ (2,000,000.00)	\$ -
	Economic Reserve	\$2,356,063.00	\$ (2,356,063.00)	\$ -
	Capital Replacement	\$ 351,150.00		\$ 351,150.00
	OPEB Reserve	\$2,094,818.00		\$ 2,094,818.00
	PERS UAL	\$ 678,711.00		\$ 678,711.00
	Designated Reserves	\$ 393,785.00		\$ 393,785.00
		\$14,462,853.00	\$ (4,950,000.00)	\$ 9,512,853.00

Recommended General Fund Reserve targets by the GFOA fall between 15% - 35% of annual expenditures depending on the risk, stability, and needs of the individual community. We reviewed the GFOA's recommended policies and completed the GFOA Risk Analysis Template and determined that the City of Lincoln is considered a moderate risk and should at a minimum maintain a 26% - 35% General Fund Reserve.

Staff also evaluated the past 32 months of General Fund revenues and expenditures to gain further insight. The General Fund runs a monthly functional deficit 10 out of 12 months. This is because the primary source of income for the General Fund is property taxes which are only received in January and May. Expenditures appear to be rather unpredictable with swings of over 100% from month to month at times with a re-occurring spike at the end of each fiscal year.

Staff also evaluated 32 months of expenditures and identified the months of May 2018, June 2018, and July 2018 as the three consecutive months with the highest expenditures (totaling \$5.4 million). If the City were to follow the 90 days working capital recommendation, this would require a minimum reserve of 27%.

Based on the GFOA risk analysis and the 90 days capital analysis, it could be determined that the City's targeted General Fund Reserve should fall into the range of 27% - 35%.



CONCLUSION:

The General Fund is the City's primary source of unrestricted funds and supports all general government services as well as Public Safety which is currently underfunded. If City Council were to refund the General Fund Reserves as currently stated, there would be less of an ability to improve Public Safety service levels as any additional excess revenue would go towards refunding the reserves. Additionally, staff has previously recommended that the following the OPEB Reserve and the Capital Replacement Reserves be modified to allow for more straightforward accounting of the associated financials.

Staff is now requesting input on the following:

- **OPEB Reserve:** It is staff's understanding that the OPEB Reserve was established prior to the establishment of the OPEB Trust that is now managed by a third party administrator. Funding of OPEB obligations is now included in the annual operating budget for each fund and listed by department. The funds are then transferred on an annual basis to the OPEB Trust. Therefore, staff has determined that it is no longer necessary to have an OPEB Reserve and instead recommends that the funding of long-term OPEB obligations be addressed in the General Fund Unassigned Fund Balance section of the General Fund Reserve Policy. Proposed language is provided below to address both OPEB Obligations and Capital Replacement Reserves.
- **Capital Replacement Reserve:** The Capital Replacement Reserve was originally intended to be a source of long-term funding for the capital replacement expenditures that would be obligations of the General Fund. Staff is still supportive of this concept, however staff recommends that the funding be transferred directly into the appropriate internal services accounts and not held in a reserve. Holding the funds in a reserve account was causing difficulties with the capitalization of the assets purchased.

Proposed new General Fund Reserve Policy language to address the intent of both the former OPEB Reserve and the Capital Replacement Reserve is provided below:

General Fund Unassigned Fund Balance

The City shall maintain a minimum Unassigned Fund balance of \$500,000 within the General Fund unless City Council deems there is prudent budgetary justification and the City's Committed Reserves for Operating, Catastrophic, and Economic are funded at 90% of their respective targeted balances for the fiscal year.

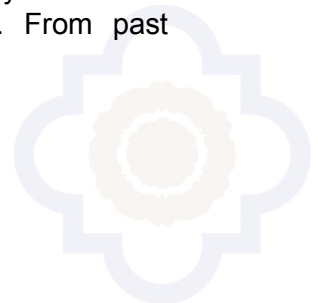




In the event that at the end of the prior fiscal year there is an amount in the Unassigned Fund balance beyond the required minimum balance, the difference would be disbursed as follows:

- 40% to fund Other Post-Employment Benefits Trust as a payment to directly to the trust.
- 40% to fund unfunded Pension Liability as an extra payment to CalPERS.
- **10%** to fund Vehicle/Equipment Replacement as a transfer to the Vehicle/Equipment Replacement Fund.
- 10% to fund Facility Maintenance/Replacement as a transfer to the Facility Maintenance/Replacement Fund.
- **Catastrophic Reserve:** The existing reserve policy includes a catastrophic reserve to be funded at a rate of \$2 million. The policy currently requires that the City Manager prepare a plan within six months of approval of the Audited Annual Financial Statements to restore the reserve to stated level within 24 months. Staff is now requesting input from City Council on whether they desire to keep the General Fund Reserve policy as stated or make changes to the policy.
- **Economic Reserve:** The existing policy requires the City to maintain a committed Economic Reserve balance of a minimum of 15% of annual General Fund operating expenditures. The policy further states that if the Economic Reserve falls below 5% of annual expenditures, the City Manager shall prepare a plan within six months of approval of the Audited Annual Financial Statements to restore the 5% level within 24 months and to the 15% level within 48 months. The replenishment of the Economic Reserve should only occur once the Catastrophic Reserve has been funded at the minimum level. Staff is now requesting input from City Council on whether they desire to keep the Economic Development Reserve policy as stated or make changes to the policy.

When considering which types of reserves the City should establish, it is important to define the problem or potential problem that could trigger a fiscal crisis. For the City of Lincoln, factors that have the greatest ability to trigger are an economic downturn (unstable revenue) and the some type of natural disaster or event. Most expenses associated with natural disasters are reimbursable once an emergency has been declared. Although the timing of the reimbursement can be delayed. From past experience, it can take up to one year to receive federal reimbursement.





REPORT ACCOUNTABILITY:

This Staff Report has been reviewed by the City Attorney for legal sufficiency and by the City Manager for content.

ATTACHMENTS:

Current General Fund Reserve Policy



RESOLUTION NO. 2018 –139

**A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF LINCOLN
APPROVING THE REVISED GENERAL FUND RESERVE POLICY**

WHEREAS, the City adopted Resolution 2017-141 during the June 27, 2017 City Council meeting, expanding the General Fund reserve components to identify adequate funding for ongoing operations and long-term obligations; and

WHEREAS, the City Council discussed revisions to the General Fund Reserve Policy during the FY 2018-19 budget workshops to allow the Unassigned Fund Balance to be below \$500,000 under certain conditions.


NOW, THEREFORE BE IT RESOLVED, that the City Council of the City of Lincoln does hereby approve the General Fund Reserves Policy as revised in substantially the form as presented.

PASSED AND ADOPTED this 26th day of June, 2018.

AYES: COUNCILMEMBERS: Karleskint, Hydrick, Gilbert, Joiner, Nader

NOES: COUNCILMEMBERS:

ABSENT: COUNCILMEMBERS:



Stan Nader, Mayor

ATTEST:



Gwen Scanlon, City Clerk

CITY OF LINCOLN GENERAL FUND RESERVE POLICY

PURPOSE

The City shall maintain adequate reserves in the General Fund to ensure that the City has sufficient funding available to meet its operating expenditures for services provided to the residents of Lincoln, respond to emergencies, fund capital needs and to fund other financial obligations. Adequate designations of reserves---funds set aside for various legitimate purposes--- are critical to the successful and stable operation of the City, both for the short-term and long-term.

Pursuant to Statement No. 54 of the Governmental Accounting Standards Board (GASB) - Fund Balance Reporting and Governmental Fund Type Definitions, fund balance may include five different components; nonspendable, restricted, committed, assigned or unassigned. The reserves policy applicable to the committed, assigned and unassigned components.

- ***Committed Fund Balance*** represents those funds that are constrained by a limitation imposed by the City Council as to the use of those funds.
- ***Assigned Fund Balance*** represents the City Council's intention to use funds for a specific purpose, but may delegate the authority and does not require formal action.
- ***Unassigned Fund Balance*** represents the remainder of fund balance.

The purpose of this Policy is to establish a target and minimum levels of reserves and unreserved fund balance to be maintained in the General Fund. Beginning with the budget for Fiscal Year 2017-18, the following General Fund Reserves shall be funded, as funding is available.

SCOPE

This policy will apply to the City's General Fund.

OBJECTIVES

Fiscal stability is an important factor for all cities to mitigate current and future risks and to ensure long-term financial planning. Sound fiscal management practices include the discipline of maintaining adequate reserve funds for known and unknown contingencies. Such contingencies and occurrences may include, but are not limited to:

1. Cash flow requirements
2. Local emergencies and disasters
3. Loss of major revenue sources
4. Economic uncertainties including downturns in the local, state or national economies
5. Unanticipated operating or capital expenditures

6. Uninsured losses
7. Future capital projects
8. Vehicle and equipment replacement
9. Capital asset and infrastructure repair and replacement
10. Funding of OPEB and PERS obligations.

In addition, minimum levels of reserves are important to:

1. Insulate the city from actions of the state that may result in a reduction of revenues.
2. Demonstrate creditworthiness to bond rating agencies and the financial community.
3. Promote both short-term and long-term financial planning and stabilization.

POLICY

Committed Fund Balance

General Fund Reserve – Operating Reserve

To maintain the ability of the City to meet operational expenses on a daily basis and provide services to the City's residents, the City shall maintain a committed Operating Reserve equal to 25% of the Annual General Fund Outflows in the adopted budget. The Annual General Fund Outflows includes operating expenditures, transfers out and allocations. Transfers within the General Fund are not included in the Annual General Fund Outflows calculation. The 25% level is based on the City's current cash flow requirements due to the timing of revenue receipts and the payment of expenditures.

If the Operating Reserve amount falls below 25% of the total budgeted General Fund outflows, the City Manager shall prepare a plan within six months of approval of the Audited Annual Financial Statements to restore the 25% level within 24 months.

This reserve is intended for normal budgeted expenditures and shall be funded before all other committed General Fund reserves.

General Fund Reserve – Catastrophic Reserve

To maintain the ability of the City to meet operational expenses during times of declared emergency or major catastrophe, the City shall maintain a committed Catastrophic Reserve of \$2 million. An emergency or major catastrophe is defined as a one-time "event" that threatens the health and safety of the community, not a recurring threat. It is recognized that during a time of emergency, the City will need to expend more resources than normal operations dictate to meet the community's needs. In addition to an increased level of expenditure, the tax base of the City may be impaired after a major catastrophic event. This reserve shall

be exclusive of all other reserves. This reserve may only be drawn upon pursuant to an emergency as declared by the City Council under the Municipal Code.

If the Catastrophic Reserve amount falls below \$2 million, the City Manager shall prepare a plan within six months of approval of the Audited Annual Financial Statements to restore the \$2 million level within 24 months.

This reserve is not intended for normal unanticipated expenditures and shall be funded after the Operating Reserve, but before all other committed General Fund reserves.

General Fund Reserve - Economic Reserve

To maintain the City's economic viability during the cyclical effects of the economy from year to year, the City shall maintain a committed Economic Reserve balance of a minimum of 15% of annual General Fund operating expenditures. This reserve shall be exclusive of all other reserves. Funding may only be disbursed based upon a resolution of the City Council.

Funding of the Economic Reserve will begin in the fiscal year following full funding of the General Fund Reserve - Catastrophic Reserve.

Once fully funded, if the General Fund Reserve - Economic Reserve falls below 5% of annual expenditures, the City Manager shall prepare a plan within six months of approval of the Audited Annual Financial Statements to restore the 5% level within 24 months and to the 15% level within 48 months. However, the replenishment of the Economic Reserve shall only occur if the Catastrophic Reserve has been funded at the minimum level.

General Fund Reserve – Capital Replacement Reserve

To maintain the ability of the City to acquire and replace public safety vehicles and equipment, or to construct and replace facilities for the community's benefit, the City shall maintain a committed Capital Replacement Reserve with annual contributions in the amount of \$300,000. The Capital Replacement Reserve may be applied in combination with the Internal Service Funds; Vehicle/Equipment Replacement Fund and the Facility Maintenance/Replacement Fund. This reserve shall be exclusive of all other reserves. Funding may only be disbursed based upon a resolution of the City Council.

Annual funding of the Capital Replacement Reserve will occur once the Operating, Catastrophic, and Economic Reserves have been funded as described above.

General Fund Reserve – Other Post Employee Benefits (OPEB) Reserve

The City recognizes the obligation to the employees for health insurance coverage after retirement from the public service of the City. The City shall maintain a committed OPEB Reserve to fund annual contributions for active employees. The

annual contributions shall be calculated in accordance with required annual financial statement reporting, applying data from bi-annual actuarial reports. This reserve shall be exclusive of all other reserves. The annual contributions shall be included in the adopted fiscal year budgets and funds from the OPEB Reserve will be transferred to the City's irrevocable OPEB Trust.

Annual funding of the OPEB Reserve will occur once the Operating, Catastrophic, Economic and Capital Replacement Reserves have been funded as described above. Annual contributions into the OPEB Trust will continue as funds are available from the OPEB Reserve.

Assigned Fund Balance

Once Committed Reserves are fully funded, the City Council may establish Assigned Reserves for designated purposes. Assigned Reserves reflect Council's intent as to the use of funds. Once assigned, funds may only be released by resolution of the City Council.

Unassigned Fund Balance

The City shall maintain a minimum balance of \$500,000 in the General Fund Unassigned (unreserved) Fund Balance, however, the minimum balance may drop below \$500,000 when (1) the City Council deems there is prudent budgetary justification and (2) the City's Committed Reserves for Operating, Catastrophic and Economic are funded at 90% of their respective targeted balances for the fiscal year.

In the event that at the end of the prior fiscal year there is an increase in the General Fund Unassigned Fund Balance, based on the annual audited financial statements, 50% of the increase that exceeds the minimum balance will be reserved to pay down the City's unfunded PERS pension liability. The transfer of funds to PERS will be authorized during the budget process following each year in which an increase occurs.